2008

Davencourt at Pilgrims Landing Townhome Owners Association v. Davencourt At Pilgrims Landing, LeGrand Woolstenhulme, Michael D. Parry Construction Company, John Does : Reply Brief of Appellants

Utah Supreme Court

Stephen Quesenberry; Charles L. Perschon; Hill; Johnson & Schmutz; Attorneys for Appellees.
A. Richard Vial; Michael B. Miller; Vial Fotheringham; Attorneys for Appellant.

An Appeal from a Final Order of the Fourth Judicial District Court, Utah County, Provo Department, the Honorable Judge James R. Taylor

IN THE SUPREME COURT OF UTAH

DAVENCOURT AT PILGRIM'S LANDING TOWNHOME OWNERS ASSOCIATION, **Plaintiff/Appellant,** **v.** **DAVENCOURT AT PILGRIM'S LANDING, LC, a Utah limited liability company; LeGRAND WOOLSTENHULME, an individual; MICHAEL D. PARRY CONSTRUCTION COMPANY, INC., a Utah corporation; and JOHN DOES 1-30,** **Defendants/Appellees.**	**APPELLANT'S REPLY BRIEF** **Supreme Court No. 20070914** **District Court No. 060401118** **(Oral Argument Requested)**

Attorneys for Appellees:

Stephen Quesenberry
Charles L. Perschon
HILL, JOHNSON & SCHMUTZ
4844 North 300 West, Suite 300
Provo, Utah 84604
Telephone:(801) 375-6600

Attorneys for Appellant:

A. Richard Vial (10875)
Michael B. Miller (11275)
VIAL FOTHERINGHAM LLP
602 East 300 South
Salt Lake City, UT 84102
Telephone: (801) 355-9594

PARTIES TO THE PROCEEDING

Plaintiff/Appellant:

Davencourt at Pilgrim's Landing Townhome Owners' Association ("Association")

Defendants/Appellees:

Davencourt at Pilgrim's Landing, LC ("Developer")

LeGrand Woolstenhulme ("Woolstenhulme")

Michael D. Parry Construction Company, Inc. ("Builder")

Amici Curiae:

MR. LINCOLN HOBBS
MS. JULIE LADLE
HOBBS & OLSON
466 East 500 South, Suite 300
Salt Lake City, Utah 84111
Attorneys for Amici the Community Associations Institute and the Utah Chapter of the Community Associations Institute

MR. CRAIG COBURN
MR. ZACHARY E. PETERSON
RICHARDS BRANDT MILLER & NELSON
Wells Fargo Center
299 South Main Street
15th Floor
Salt Lake City, Utah 84111
Attorney for Amici American Institutde of Architects-Utah, American Council of Engineering Companies, Associated General Contractors, and Utah Subcontractors Council

MR. STANFORD FITTS
STRONG & HANNI
3 Triad Center, Suite 500
Salt Lake City, Utah 84180
Attorney for Amici National Association of Home Builders and Utah Valley Home Builders' Association

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

ARGUMENT

I. THE RELATIONSHIPS BETWEEN THE PARTIES DEFINE DUTIES NOT CONTAINED IN ANY CONTRACT. THEREFORE, THE ECONOMIC LOSS RULE CANNOT APPLY.

The most fundamental concept driving this case is the unique relationships created by, and the obligations imposed upon, the parties at Davencourt. The special nature of these relationships provides the backdrop as to why the Association's claims demand a different application of the economic loss rule.

As stated by the Appellees, the economic loss rule "marks the fundamental boundary between contract . . . and tort law". (Appellees' Br. 11, citing Hermansen v. Tasulis, 2002 UT 52, ¶13, 48 P.3d 235.) Contract law is designed to enforce the expectancy interests of the contracting parties, while tort law imposes a duty of reasonable care that encourages individuals to avoid causing foreseeable harm to others. See Hermansen, 2002 UT 52, ¶13. The Appellees proffer that "where a party enters into a contract, contract law (not tort law) governs 'the bargained-for duties and liabilities' of those who exercised their freedom of contract." (Appellees' Br. 11, citing Grynberg v. Questar Pipeline Co., 2003 UT 8, ¶41, 70 P.3d 1.) Conversely, in the absence of bargained-for contracts, it is clear that tort law must govern, especially where obligations and responsibilities are unilaterally imposed upon the non-contracting party. In this case, since the Association had no opportunity to bargain for and allocate any risk for its obligations, the Developer and Builder must be liable for their negligence in tort.

The Association was organized and created by the Developer upon the filing of the Declaration of Easements, Covenants, Conditions and Restrictions ("Declaration"). (R.

at 587.) The Developer, pursuant to the Declaration, required the Association to accept title to the common areas and to maintain, repair, and replace the common areas, exterior surfaces, roofs, porches, streets, and sidewalks. (R. at 576.) It cannot be disputed that these obligations and responsibilities were unilaterally imposed upon the Association by the Developer. While the Association argues the Declaration is a contract between it and the Developer, the Association was not afforded any opportunity to negotiate its terms and discount its obligations for any apparent risks. The items, which the Association is obligated to repair and maintain were built and constructed by the Builder who is only in direct privity of contract with the Developer. There are no contracts between the Builder (or its various subcontractors) and the Association.

Furthermore, the Developer not only unilaterally created and burdened the Association with significant maintenance and repair obligations, but the Developer also controlled the Association for several years until the Association was turned over to its members. This illustrates another significant reason why the policy behind the economic loss rule is thwarted in the homeowner association ("HOA") context: An HOA cannot engage in an arm's-length bargain with the very entity that controls it. The law cannot assume equal bargaining power where the HOA is unable to negotiate for and adjust accordingly its obligations and responsibilities. Thus, the developer is not at arm's-length, but is a fiduciary to the HOA. This Court has declared that where disparity in circumstances "distorts the balance between the parties in a relationship to the degree that one party is exposed to unreasonable risk, the law may intervene by creating a duty on the advantaged party to conduct itself in a manner that does not reward exploitation of its

advantage." Yazd v. Woodside Homes Corp., 2006 UT 47, ¶ 16, 143 P.3d 283. The disparity existing between the Association and the Appellees clearly requires this Court's intervention, since the Association had to rely exclusively upon the Builder and Developer who built and created it.

The Association, therefore, asks this Court to recognize that in the absence of bargained-for contractual privity, the economic loss rule does not preclude the Association from pursuing its tort-based claims. The barring of such, defeats all of the policy reasons behind tort jurisprudence.

II. APPELLEES OWE INDEPENDENT DUTIES TO THE ASSOCIATION. THIS CASE IS OF FIRST IMPRESSION UNDER THE EXPANDED INDEPENDENT DUTY STANDARD ADOPTED WITH REGARD TO THE ECONOMIC LOSS RULE.

Appellees argue that this case "is the biological twin" of American Towers Owners Ass'n v. CCI Mechanical, Inc., 930 P.2d 1182 (Utah 1996) and, as a result, that this Court should automatically rule against the Association in the same manner that the Court ruled against the homeowners association in American Towers. (Appellees' Br. 9.) However, their argument ignores this Court's own statement in Grynberg that American Towers was decided under a different standard or rule and therefore has, at a minimum, diminished precedential value.

> The language of American Towers Owners Ass'n and SME Industries, two Utah construction cases, relied upon the products liability-based language of economic loss. In Hermansen v. Tasulis, we expressly adopted the independent duty-based rule articulated in Town of Alma and held that "the initial inquiry in cases where the line between contract and tort blurs is whether a duty exists independent of any contractual obligations between the parties." . . . ***Since they were decided before we adopted Colorado's interpretation, . . . we do not find American Towers Owners Ass'n and***

***SME Industries* persuasive authority regarding the current state of the economic loss rule in Wyoming or Utah.**

Grynberg, 2003 UT 8, ¶49 (emphasis added). As this Court acknowledged in Grynberg, the decision in American Towers did not take into consideration the relationships of the litigants, nor did it assess whether the defendants owed independent duties to the homeowners association. **That fundamental difference in analysis is paramount here.** Whether independent duties exist in a construction defect case involving an HOA is a case of first impression before this Court. For this reason alone, American Towers does not resolve this case.[1]

Surprisingly, notwithstanding this Court's plain statement about the expanded analysis under the economic loss rule first formulated in Hermansen, Appellees are still calling this Court's adoption of Colorado's interpretation of the economic loss rule a "narrow exemption," a "slight evolution" or a "slight[] change[]" in the law.[2] (Appellees'

---

[1] Defendants also cite to Snow Flower Homeowners' Ass'n v. Snow Flower, Ltd., 2001 UT App 207, 31 P.3d 576, to support their contention that American Towers decides this matter. However, like American Towers, Snow Flower was also decided prior to this Court's adoption of Colorado's interpretation of the economic loss rule in Hermansen and, therefore applies the old (pre-Hermansen) standard and analysis of the economic loss rule.

[2] Defendants also argue that the Association overstates the impact of the change of law enunciated in Hermansen. (Appellees' Br. 21-23.) Their argument, though, ignores that the Association's contentions are consistent with the understanding of others who have interpreted the change in the economic loss rule post-Hermansen. Appellate courts from at least two other states who have had to interpret Utah law on the economic loss rule in a case before them did so also under the belief that Utah completely adopted Colorado's version of the economic loss rule. Gulfstream Aerospace Services Corp. v. United States Aviation Underwriters, Inc., 635 S.E.2d 38, 44 (Ga. Ct. App. 2006) ("The Supreme Court of Utah has expressly adopted the economic loss rule as interpreted and applied by Colorado courts."); Air Products and Chemicals, Inc., v. Eaton Metal Products Co., 272 F.Supp.2d 482, 491-93 (E.D. Pa. 2003) ("In 2002, the Utah Supreme Court adopted

Br. 15-21.) In other words, they argue that American Towers is still good law even though the decision in American Towers was not reached under the analytical standard in effect today.

However, Appellees ignore that the change fundamentally alters the analysis of any claim, tort or contract, involving the economic loss rule. The American Towers decision did not even address, let alone recognize, that duties independent of any contractual obligation were sources of an action in tort. Grynberg recognized this flaw in the American Towers decision and, accordingly, casts doubt on the continuing validity or persuasiveness of American Towers.

In assessing whether an "independent duty" exists, courts look at the source of the duty alleged to have been violated. Hermansen, 2002 UT 52, ¶ 16; Town of Alma v. Azco Constr., Inc., 10 P.3d 1256, 1262 (Colo. 2000); Gulfstream Aerospace Services Corp., 635 S.E.2d at 45 (citing Parr v. Triple L & J Corp., 107 P.3d 1104, 1107 (Colo. Ct. App. 2004); BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66, 74 (Colo. 2004); Grynberg v. Agri Tech, Inc., 10 P.3d 1267 (Colo. 2000)) (analyzing and applying Utah and Colorado law on economic loss rule for case involving damage to airplane that caught on fire over Utah and made emergency landing in Colorado). If there are any duties arising outside of those contained within a properly negotiated transaction, then tort law applies. Town of Alma, 10 P.3d at 1262.

Colorado's version of the economic loss doctrine . . . ." "Because it has adopted wholesale Colorado's version of the doctrine, we predict that the Utah Supreme Court would follow Colorado's fuller exploration of this issue.").

At the trial court level and in its opening brief, the Association has examined multiple duties that Appellees, in their individual capacities, owe to the Association and the owners. In short, those duties are based upon the special relationship that each of those parties has with the Association and owners. "We have recognized that some special relationships by their nature automatically trigger an independent duty of care that supports a tort action even when the parties have entered into a contractual relationship." Id. at 1263.

Appellees state that because Developer and Woolstenhulme are developers, and Parry Construction is a builder (as opposed to real estate brokers, agents, or appraisers) that they owe no independent duties. (Appellees' Br. 31.) The Association disagrees. This Court has noted that such duties can exist where "disparity of skill and knowledge" may lead one party to rely more heavily on the other's expertise. Yazd, 2006 UT 47, ¶24. Contrary to Appellees' claim that no such relationship exists in this case (Appellees' Br. 31), the relationship between the Association and Appellees is precisely the type of relationship that gives rise to an independent duty. Yazd, 2006 UT 47, ¶ 16 and ¶24.

Furthermore, Utah law imposes on developers and builders an extra-contractual duty to disclose any specialized knowledge obtained during the course of the development and construction that is material to potential buyers. See Yazd, 2006 UT 47, ¶35; Smith v. Frandsen, 2004 UT 55, ¶ 28, 94 P.3d 919; Loveland v. Orem City Corp., 746 P.2d 763, 769, n. 5 (Utah 1987). This duty to disclose and the exposure to unreasonable risk are especially prevalent in an HOA setting. It is unreasonable and impracticable for owners to inspect the common areas and other structures maintained by

the HOA since: (1) the HOA repairs and maintains them, and (2) the costs associated with an inspection of the outside envelope of a multi-unit building (or multiple buildings) is prohibitive. For example, there are 38 buildings and 145 townhomes at Davencourt. An inspection of that scope would be unreasonable and cost-prohibitive for an individual purchaser. The Association was, therefore, forced to rely on the information presented to it by the Appellees.

Finally, the Association has alleged that Developer and Woolstenhulme were fiduciaries of the Association and the unit owners. (R. at 29-25.) Fiduciaries owe duties to their constituents and those fiduciary obligations are independent duties that arise at law. Norman v. Arnold, 2002 UT 81,¶ 35, 57 P.3d 997. Thus contrary to the Appellees' assertion, Utah case law recognizes numerous independent duties running from the Developer and Builder to the Association.

III. UTAH CASE LAW DEMONSTRATES A CLEAR, CONSISTENT MOVEMENT AWAY FROM THE ECONOMIC LOSS RULE AS STATED IN AMERICAN TOWERS.

This Court's recent case law shows a continuous movement away from the economic loss rule as expressed in American Towers. That retrenchment began with Hermansen and has been expanded in the subsequent cases of Grynberg, Smith, West v. Inter-Financial, Inc., 2006 UT App 222, 139 P.3d 1059., Yazd, and Moore v. Smith, 2007 UT App 101, 158 P.3d 562., all of which demonstrate that American Towers and the cases following it are no longer persuasive authority on the state of the economic loss rule.

1. **SME[3], Snow Flower and Fennell[4] were Decided Before or During the Early Stages of this Court's Shift Away from American Towers and do not Accurately Represent Current Law.**

SME and Snow Flower were decided before this Court's shift away from the American Towers interpretation of the economic loss rule. These cases, which as Appellees point out, were released only two days apart (Appellees' Br. 14), represent American Towers at its peak, before Hermansen and subsequent cases retrenched the American Towers holding. In fact, Grynberg specifically names SME as a case that is no longer persuasive authority on the economic loss rule. Grynberg, 2003 UT 8, ¶ 49.

Like SME and Snowflower, Fennell does not represent the current state of the economic loss rule. While Fennell followed both Hermansen and Grynberg, its holding has been limited by this Court's Smith and Yazd decisions. Fennell, 2003 UT App 291. Fennell, a Court of Appeals case, held that the economic loss rule barred negligent misrepresentation claims, Id. at ¶15, which were not barred under Smith and Yazd. See infra, III, 4. The Court of Appeals likely agrees since the Fennell decision cannot be reconciled with its more recent Moore decision, where negligent misrepresentation claims were deemed "viable." Moore, 2007 UT App. 101, ¶40. Thus, Fennell, like American Towers, Snow Flower, and SME cannot be viewed as representing the current law with regard to the economic loss rule.

---

[3] SME Indus., Inc. v Thompson, Ventulett, Stainback & Assocs., Inc., 2001 UT 54, 28 P.3d 669.

[4] Fennell v. Green, 2003 UT App 291, 77 P.3d 339.

2. **West, Moore, Yazd and Smith have Followed Colorado's Economic Loss Rule, and Show that Hermansen is not an Aberration.**

The case law clearly shows that Hermansen was not carving out one narrow exception to the economic loss rule, but created a broad category of independent duties. West creates an independent duty to disclose accurate and complete information running from real estate appraisers to purchasers, separate from a realtor's similar independent duty to disclose in Hermansen. West v. Inter-Financial, Inc., 2006 UT App 222, ¶29, 139 P.3d 1059. While the Appellees are right that the West exception to the economic loss rule is logical after Hermansen, (Appellees' Br. 20), West still recognized yet another independent duty entirely separate from Hermansen. West, 2006 UT App 222, ¶29. The subsequent cases of Moore, Yazd, and Smith have expanded upon these two duties, recognizing another independent duty to disclose material information to purchasers. See infra, III, 4. Thus, this Court's cases show that it has rejected the American Towers line of cases (SME and Fennell) and followed Colorado's independent duties analysis by recognizing numerous independent duties.

3. **The Case Law does not Clearly Limit the Economic Loss Rule to Construction Cases, and the Policy Reasons for Making that Limitation are Unpersuasive.**

Probably in recognition that Utah's current case law does in fact recognize numerous independent duties, Appellees next attempt to argue that those duties only apply in the non-construction context. (R. at 29-30.) Appellees use West to argue that American Towers controls in the construction or design context, and Hermansen controls in other professional contexts. West, 2006 UT App 222, ¶22. That distinction however, is

wholly unpersuasive in light of Yazd and Smith, which recognize an exception to the economic loss rule for construction professionals. See infra III, 4. Furthermore, the Utah Court of Appeals implicitly abandoned the distinction between construction and non-construction when, in Moore, it allowed a negligent misrepresentation claim to proceed, even though the claim was asserted against a developer. Moore, 2007 UT App 101, ¶ 39, 158 P.3d 562. If American Towers still controlled in all cases affecting the improvement and sale of real property the negligent misrepresentation claims would clearly have been barred by the economic loss rule.

Looking at SME and Grynberg together, this Court has also implicitly recognized that the independent duty analysis applies to construction and non-construction professionals alike. For example, while in SME, this Court "expressly limited the economic loss rule to bar tort actions against construction and design professionals, but left the door open for actions against other professionals" (West 2006 UT App 222, ¶ 12, citing SME, 2001 UT 54, ¶ 38 n. 9), Grynberg, however, rejected the construction professionals distinction by holding that SME was not persuasive authority on the state of the economic loss rule. Grynberg, 2003 UT 8, ¶49.

Furthermore, the reasoning in West that the economic loss rule is particularly applicable to construction is wholly unpersuasive. West, 2006 UT App 222, ¶ 8. Citing to American Towers, the West court reasoned that "'the economic loss rule is "particularly applicable" to construction and design situations because parties "can avoid economic loss" with contracts and are thus "free to adjust their respective obligations to satisfy their mutual expectations.'" Id., (citing American Towers, 930 P.2d at 1190). The economic

loss rule is supposed to prevent tort law from thwarting the intentions of the contracting parties. Nothing about that policy is specific to construction contracts. Neither the West court, nor Appellees provide a persuasive reason why parties can "adjust their respective obligations to satisfy their mutual expectations" through a construction contract but not through a non-construction contract. Perhaps that is why subsequent decisions, like Smith, Yazd, and Moore, have rejected the distinction.

4. Together, Smith, Yazd and Moore Create an Independent Duty to Disclose Conditions that are Known or that Should be Known by both a Developer and Builder.

Appellees omit Smith, Yazd and Moore from its list of Utah cases dealing with the economic loss rule. (Appellees' Br. 12.) Viewed together, Yazd and Smith recognize a duty outside the economic loss rule to disclose specialized knowledge, and Moore confirms the Court of Appeal's interpretation of that analysis provided by this Court.

Smith recognized that a developer can have a duty to disclose material information to purchasers. (Smith, 2004 UT 55, ¶ 16; Loveland, 746 P.2d at 769). In Yazd, the Court found that the duty to disclose also applied to builders, and remanded the case to be decided on the facts. Yazd, therefore, without specifically discussing the economic loss rule, implicitly recognizes that the economic loss rule does not bar the duty to disclose, otherwise, the case could have been decided on the legal issue, and there would have been no need to remand it.

Appellees try to limit Yazd to its facts, saying that Yazd dealt with a narrow fraudulent non-disclosure case where the economic loss rule does not apply, but the holding in Yazd is clearly broader than that. The Yazd court clearly states that Yazd is an

extension of Smith (Yazd, 2006 UT 47, ¶ 26), which held there was a duty to disclose that extended to both fraud and negligent nondisclosure claims. Moreover, Moore was decided after Yazd and clearly holds that negligent nondisclosure is an exception to the economic loss rule. Moore, 2007 UT App 101, ¶ 39. Thus, the Court of Appeals agrees with the Association: Utah case law recognizes an exception to the economic loss rule for a breach of the duty to disclose, whether the breach is negligent or otherwise.

Thus, with the exception of Fennell, which was partially overruled by Smith, Yazd and Moore, every economic lose rule case since Hermansen, (Grynberg, West, Frandsen, Yazd and Moore) has recognized independent duties beyond any contract in those cases, and has expanded those duties.

IV. SENATE BILL 220 DOES NOT APPLY TO THIS CASE.

Appellees and their supporting Amici parties argue extensively that this Court must defer to the legislature's recent attempt to codify American Towers[5] via Senate Bill 220 ("SB 220), located at Utah Code Ann. §78B-4-513, which they allege reflects the voice of Utah's citizens.[6] (Appellees' Br. 9.) However, it is clear that SB 220 does not apply to, and should have no impact upon this case.

---

[5] As explained above, American Towers is no longer persuasive authority with regard to the economic loss rule, since it was abandoned for the independent duty framework. Grynberg, 2003 UT 8, ¶49. If SB 220 is interpreted to do what it was intended to do—namely restore American Towers to its past glory—then other decisions like Hermansen, West, Smith, Yazd, and Moore which recognize exceptions to the American Towers rule, are also abrogated by the statute.

[6] During House Floor Debate on SB 220, the Sponsor of the bill in the House, Representative Steve Urquhart, specifically said that the bill was an attempt to codify American Towers. http://recordings.le.state.ut.us/mp3/House/rhouse-0303082.mp3 See

SB 220 was codified on May 5, 2008, approximately two years after the Association filed this lawsuit and several years after the townhomes at Davencourt were built. Utah law provides that "[n]o part of [Utah Code] is retroactive, unless expressly so declared." See Utah Code Ann. §68-3-3; see also, Soriano v. Graul, 2008 UT App 188, ¶6, 186 P.3d 960. Furthermore, this Court has repeatedly held that "a statute is not to be applied retroactively unless the statute expressly declares that it operates retroactively." Goebel v. Salt Lake City S. R.R., 2004 UT 80, ¶39, 136 P.3d 1185. Since SB 220 does not contain express retroactive language, it is inapplicable to the Association's claims and should not have any bearing on this Court's decision.[7]

V. THE COURT SHOULD FIND IN FAVOR OF THE ASSOCIATION'S CLAIM FOR BREACH OF IMPLIED WARRANTIES.

1. SB 220 Explicitly Provides A Remedy for Implied Warranties.

Appellees urge this Court to apply and consider SB 220 and its underlying policy to this case. (Appellees' Br. 32-34.) However, as explained above, not only is the statute inapplicable since it has no retroactivity language, the statute is likely unconstitutional,

---

also, Addendum 1 showing the bill's sponsors' (the Utah Home Builders Association; Utah Association of Realtors; and the Utah Property Rights Coalition, a group made up of the largest real estate development companies in Utah) intent to codify American Towers.

[7] While SB 220 is clearly inapplicable to this case, the Association believes it violates the Open Courts clause of the Utah Constitution, which guarantees every person the right to access the courts to receive "remedy by due course of law" for injury to "person" or "property." Utah Const. Art. I, § 11. SB 220 is an attempt to deny plaintiffs, like the Association, all remedy for damage to property. See also Berry ex. rel. Berry v. Beech Aircraft Corp., ("if the Legislature were to abolish all negligence actions [...] and provide no substitute remedy [...] [it] would be unconstitutional.") 717 P.2d 670, 676 (Utah 1985).

and this Court should not follow the policy underpinnings of an unconstitutional statute.

Nevertheless, if this Court is inclined to recognize the policy behind SB 220, the Association requests that it also recognize an implied warranty of habitability. SB 220 specifically provides that an action "for defective design or construction is limited to breach of the contract, whether written or otherwise, including both express and implied warranties." Utah Code Ann. §78B-4-513(1). While Appellees have argued that Utah has not recognized an implied warranty of habitability (Appellees' Br. 40-45), SB 220 clearly provides injured plaintiffs recourse under an implied warranty. If the Court is willing to defer to one part of the statute dealing with the economic loss rule, it should also defer to the part recognizing an implied warranty of habitability.[8]

2. Recent Case Law Supports Recovery for Implied Warranties.

Ignoring the statute, there is another compelling reason that this Court should recognize an implied warranty of habitability. Courts usually reject implied warranties under the false assumption that buyers and sellers of residential property "have similar bargaining power." American Towers, 930 P.2d at 1195. However, this Court, in more recent cases, has recognized that home purchasers do not in fact have the kind of specialized knowledge they need to effectively bargain with sophisticated contractors and developers. See Yazd, 143 P.3d 283, ¶ 24 ("Modern home construction requires a high degree of knowledge and expertise [...]. We have found that the disparity in skill and

[8] During House Floor Debate on SB 220, House Representatives, on at least two occasions, specifically stated the validity of an Implied Warranty of Habitability. The audio of the floor debate can be heard at the following: http://recordings.le.state.ut.us/mp3/House/rhouse-0303082.mp3

knowledge between home buyers and builder-contractors leads buyers to rely on the builder-contractor's expertise."), Smith, 2004 UT 55, ¶16 ("[I]n order to protect unsophisticated purchasers, under Loveland, a developer, subdivider or person performing similar tasks has a duty to exercise reasonable care to insure that the subdivided lots are suitable for construction), citing to McDonald v. Mianecki, 398 A.2d 1283, 1292 (1979) ("Whether the builder be large or small, the purchaser relies upon his superior knowledge and skill, and he impliedly represents that he is qualified to erect a habitable dwelling. [The builder] is also in a better position to prevent the existence of major defects.") and Moxley v. Laramie Builders, Inc., 600 P.2d 733, 735 (Wyo. 1979) ("Consumer protection demands that those who buy homes are entitled to rely on the skill of the builder and that the house is constructed so as to be reasonably fit for its intended use."). Having repeatedly accepted the policy justification for an implied warranty of habitability, and with the Utah legislature affirming the viability of a cause of action for a breach of an implied warranty, this Court should now hold that such an implied warranty of habitability exists in Utah.

3. By Creating a Cost-Sharing Mechanism within the Association, the Developer Impliedly Represented that the Units were of Good Quality, or that the Assessments were Adequate to Meet the Association's Obligation to Repair them.

The Developer made representations outside the contractual arrangements that warrant that the construction was of sufficient quality and durability that the Association's repair and maintenance fund would not be overwhelmed with costs to replace negligently constructed portions of the buildings and repair resulting damages.

Specifically the Developer created a unique covenant-based contractual arrangement whereby the unit owners own the units in name, but the Association has the exclusive legal obligation and duty to maintain the very systems which envelop and protects them. This system creates interdependency between the unit owners by forcing them to cast their resources together to fund the operations of the Association as a group, allowing the Association to fulfill its obligation to repair and maintain the exterior walls, roofs, and porches of the units. This cost-sharing system of maintenance implicitly represents that assessments, which were set and controlled by the Developer until turnover to the members, were adequate to meet the repair obligations of the Association.

The Developer created the Association, was intimately involved in the construction process, and was responsible for setting the assessment rate. By controlling and overseeing the construction process (R. at 42), a developer has constructive knowledge of the quality of construction. Smith, 2004 UT 55, ¶ 20 ("[The contractor] is deemed to possess the knowledge of a reasonably prudent builder-contractor under similar circumstances and, as a matter of law, a builder of ordinary prudence would have discovered the insufficient compaction on lot 223."). For example, in this case, the Developer and Builder not only had constructive knowledge, but actual knowledge of the collapsible soils throughout the Project. (R. at 290.)

In addition to its construction duties, the Developer had the responsibility to set the initial assessment rates of the Association. Because the Developer was aware of the Association's monthly expenses, its maintenance responsibility, and the construction-defects rampant throughout the Project, the Developer was required to set the assessment

rates high enough, to cover both the normal operation expenses of the Association and to fund a reserve account for replacement and maintenance of the building components. By choosing the assessment level it did, the Developer implicitly represented to unit purchasers and to the post-turnover Association Board of Directors that the assessments were set at a high enough level to cover any necessary repairs.

Unfortunately, the Developer not only failed to disclose the material latent defects throughout Davencourt, the Developer also set the monthly assessments at a rate insufficient to adequately fund the reserve account and cover the necessary construction repairs. (R. at 37.) In fact, not only did the Developer make these implied misrepresentations, but he knowingly handicapped the Association from making the necessary assessment rate increases once the latent defects were discovered. For example, the Developer in Section 13.07 of the Declaration capped the annual assessments at $840 per unit. (R. at 574.) The Developer further prevented the Association from increasing assessments to adequate levels by establishing a maximum annual increase of fifteen percent (15%). (R. at 574.)

As a result, the Developer clearly implied that the construction was of sufficient quality that the annual increases were unnecessary and that the assessments were set at an adequate level to replace the necessary building components. Since the Developer was both intimately familiar with, and responsible for, the construction, assessment rates, and assessment capping, the Developer should be held responsible.

The Developer made these representations, not only to the initial unit owners, but also to the post-turnover Association. Not only did the Association rely upon the

adequacy of the Developer's initial assessment structure, but the Developer, via the Declaration, prevented the Association from making the necessary increases. The Association was entitled to so rely, based upon the Developer's intimate knowledge of the construction process and its control of the Association. The Developer clearly breached a duty it owed to the Association independent of any contract.

VI. THE APPELLEES' THEORY THAT THE ASSOCIATION SHOULD PROTECT ITSELF BY INSISTING THE DEVELOPER ASSIGN ITS CONTRACTUAL RIGHTS TO THE ASSOCIATION IS UNWORKABLE AND NAÏVE.

The Appellees want the Court to believe that the complex issues inherent in this case can be handled easily by having the developer assign its contractual rights against the builder to the HOA. (Appellees' Br. 10-11.) This solution is simply not viable and incredibly naive.

A contract "negotiated by the developer" is not a contract negotiated by the HOA regardless of whether the developer is the builder (as is frequently the case), the developer and the builder are related parties, or whether they are completely independent. In this case, the Developer's and Builder's interests are potentially adverse. Yet the Builder and Developer have decided to hire one law firm, and limit their defenses to those that protect both parties, presumably to maintain a pre-litigation business relationship.

The solution urged upon the Court by the Appellees (clearly arising out of the language of SB 220), begs the further question of which "contract" is it that would be assigned? Is it the agreement with the general contractor? Is it the agreement with any

design professionals? What about subcontractor agreements? Perhaps it is an agreement between the developer and the selling entity? Or maybe we are expecting the developer to "negotiate" an agreement with the newly created and wholly controlled HOA which is not tainted by the profit motive!

Any attempt to respond to the suggestion made by the Appellees only serves to highlight the difficulty with applying traditional notions of contract, which address the rights and liabilities of the parties, to the type of relationships created by the project at issue in this case. It simply makes no sense to allow the developer to "negotiate" the rights of future owners by creating or assigning a contract with or to an HOA that is without the benefit of an arm's-length relationship.

VII. THIS COURT SHOULD REVIEW THE TRIAL COURT'S DECISION FOR CORRECTNESS, NOT FOR ABUSE OF DISCRETION.

1. This Appeal is from both the Motion to Dismiss, and the Denial of Plaintiff's Motion to Amend.

Because this is an appeal from the trial court's first September 21, 2006 Memorandum Decision ("2006 Memo"), which decided the Appellees' motion to dismiss, this Court should apply the 12(b)(6) standard and review the district court's decision "for correctness, granting no deference to the district court's ruling." Pendleton v. Utah State Bar, 2000 UT 96, ¶ 5, 16 P.3d 1230.

While it is true that this appeal was taken as a matter of right when the trial court certified its September 11, 2007 Memorandum Decision ("2007 Memo") as final under rule 54(b) of the Utah Rules of Civil Procedure (R. 658.), all of the claims at issue in this case, which the Association was denied leave to reinstate in the 2007 Memo, were first

dismissed by the trial court under a 12(b)(6) standard in the 2006 Memo. This Court should, therefore, apply the 12(b)(6) standard of review because a reversal of the dismissal in the 2006 Memo would make the denial of leave to amend in the 2007 Memo moot.

The fact that the Association asked the trial court for leave to amend to reinstate dismissed claims before it proceeded to appeal does not mean that the 12(b)(6) standard of review should be replaced with the denial of leave to amend standard. (Appellees' Br. 45, asserting abuse of discretion standard applies.) The Association has the right to appeal both decisions once made final. Utah R. App. P. 3. The trial court clearly thought the appeal was from the 2006 Memo when it discussed it in light of the Association's request to certify the case for appeal. (R. at 658.) The Association also made it clear that it intended to appeal both decisions when it said it was appealing from both in its Notice of Appeal and when it attached both as exhibits to the Docketing Statement. Thus, this appeal is from both memorandum decisions, not just the second. Thus, again, the 12(b)(6) standard of review (for correctness) must apply to decide whether the claims should be reinstated.

2. The Motion to Amend Should be Reviewed under the Correctness Standard.

The Association moved the trial court to amend the complaint to both add new parties and new facts, and to amend to reinstate dismissed claims. (R. at 667.) The trial court implicitly acknowledged that the only reason it did not reinstate the claims was because it rejected the legal arguments for recovery despite the new case law and facts. (R. at 658.) Furthermore, the trial court specifically stated that the case was in its early

stages and acknowledged that no prejudice would befall newly added parties if it granted the Appellant leave to bring in additional parties. (Id.) Thus, even if this appeal were only from the 2007 Memo, the Court should review the case for correctness because the trial court's denial of leave to amend was based only on the legal question of whether the Association stated a valid legal claim for relief, not on any question of fact or discretion. Drake v. Industrial Com'n of Utah, 939 P.2d 177 (Utah 1997).

3. The Trial Court has Abused its Discretion.

While the Association believes that abuse of discretion is the wrong standard to apply to this appeal, even if it is the correct standard, the trial court's denial of leave to amend is an abuse of discretion. Under the law of the case doctrine, more particularly known as the mandate rule, a lower court must follow the case law of the appellate courts. Thurston v. Box Elder County, 892 P.2d 1034, 1037 (Utah 1995). The trial court abused its discretion by denying the Association its right to reinstate claims based on the new case law, specifically Yazd, Smith, and Moore, and its discovery of the Appellees' knowledge of, and failure to disclose, collapsible soils. That reinstatement was not discretionary, and therefore, the trial court's denial was an abuse of discretion and should be reversed.

CONCLUSION

Among King Hammurabi of Babylon's Code of Laws were several which regulated the building contractors of the time. Of the 282 codes, numbers 228 through 233 are those which represented the rules for construction:

228. If a builder has built a house for a man, and finished it, he shall pay him a fee of two shekels of silver, for each SAR built upon.

229. If a builder has built a house for a man, and has not made his work sound, and the house he built has fallen, and caused the death of its owner, that builder shall be put to death.

230. If it is the owner's son that is killed, the builder's son shall be put to death.

231. If it is the slave of the owner that is killed, the builder shall give slave for slave to the owner of the house.

232. If he has caused the loss of goods, he shall render back whatever he has destroyed. Moreover, because he did not make sound the house he built, and it fell, at his own cost he shall rebuild the house that fell.

233. If a builder has built a house for a man, and has not keyed his work, and the wall has fallen, that builder shall make that wall firm at his own expense.

Codex Hammurabi, Babylon (1792-1750 BC)

While some may wish that we lived in a society where the simplicity of Hammurabi's Code could answer questions like those before the Court, modern practices involving the improvement of real property for use as both shelter and place of business have become infinitely more complex than was recognized by King Hammurabi. Today the relationships involving land preparation, planning and zoning, engineering and design, financing and marketing, calculation of maintenance reserves, and acquisition of appropriate insurance, not to mention the actual construction itself – which often involves dozens of independent parties, creates a complex interwoven set of legal rights and

obligations. This is exacerbated in the case of an HOA, where to one degree or another, those who will occupy the improved real property are forever bound by interdependent obligations and rights which are critical to the viability of the improved real property itself, and yet they were not even a party to the creation of those critical rights and obligations. The reality of this complexity is that even well-intentioned attempts to frame and limit by contract the obligations and rights inherent therein is ultimately futile.

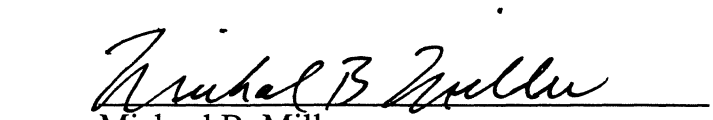
Were it so that the Codex Hammurabi could be "tweaked" to satisfy the demands and realities of modern society, all would be much simpler. It is the fear of the Association that the Utah legislature in enacting SB 220 has attempted to do just that. Unfortunately, the timing of its adoption does not allow the Association to claim that the issue has been properly preserved so as to argue its constitutionality, but the Court's opinion in this case will no doubt be read carefully by all those parties to these complex transactions. It is clear that this case turns on the pivotal question of whether American Towers finally and completely answered all of those thorny questions placed before the trial court as reflected in its 2006 and 2007 memorandum decisions. The position of the parties is obviously clear. The Association cannot reconcile the lack of contractual rights, protections, and responsibilities with the seeming obvious obligations of those who participated in creating what they now are required to live with. Those who collaborate to perform all of the myriad tasks involved in the creation of these real property constructs have clearly stated, both by legislative fiat and in the positions taken before our judiciary, the desire to simplify these relationships even when it cannot reasonably be done.

HOAs are a fact of life in Utah that is not going to reverse itself. As the availability of land suitable for construction of homes continues to shrink by consumption and municipalities continue to require developers to construct and provide a vehicle for maintenance of many of the traditional common facilities or amenities which consumers have come to reasonably expect, an increasingly large percentage of Utah's homeowners will find themselves involved in these complex interdependent relationships.

The Association is not asking for unnecessary complexity. The Association simply asks the Court to recognize the reality that a single owner cannot meaningfully influence the contract(s) that results in the construction of these complex projects. For cabinets, floor coverings, finishings, etc., it may be possible for a contract between the seller and purchaser of an HOA to reflect their negotiated expectations. But it is impossible that each of one-hundred or more owners could so negotiate without rendering the effort meaningless in a chaos of inconsistency. This is doubly true when we realize that in nearly every case the project is complete before the purchaser arrives.

A modern condominium or attached multi-family HOA complex is not a product. A toaster is a product. This case is not simply a construction defect case. This case requires the Court to analyze the profusion of unavoidable relationships required to bring about this type of project. Not all of those relationships can be or should be expected to be reflected in the simplicity argued by the Appellees.

RESPECTFULLY SUBMITTED this 13TH day of October 2008.



Michael B. Miller
A. Richard Vial
Attorneys for Appellant

CERTIFICATE OF SERVICE

On this 13TH day of October, 2008, I sent two true and correct copies of the foregoing **APPELLANT'S REPLY BRIEF,** via first class mail, postage pre-paid, to the following:

MR. STEPHEN QUESENBERRY
MR. CHARLES L. PERSCHON
HILL, JOHNSON & SCHMUTZ, L.C.
4844 North 300 West, Suite 300
Provo, Utah 84604
Attorneys for Appellees

MR. LINCOLN HOBBS
MS. JULIE LADLE
HOBBS & OLSON
466 East 500 South, Suite 300
Salt Lake City, Utah 84111
Attorneys for Amici the Community Associations Institute and the Utah Chapter of the Community Associations Institute

MR. CRAIG COBURN
MR. ZACHARY E. PETERSON
RICHARDS BRANDT MILLER & NELSON
Wells Fargo Center
299 South Main Street
15th Floor
Salt Lake City, Utah 84111
Attorney for Amici American Institute of Architects-Utah, American Council of Engineering Companies, Associated General Contractors, and Utah Subcontractors Council

MR. STANFORD FITTS
STRONG & HANNI
3 Triad Center, Suite 500
Salt Lake City, Utah 84180
Attorney for Amici National Association of Home Builders and Utah Valley Home Builders' Association

ADDENDUM

1. Utah Property Rights Coalition Newsletter, Spring 2008, Vol. 1, (April 4, 2008). Located at: http://mikemorley.org/includes/files/property-rights-coalition-newsletter.pdf

ADDENDUM 1

Utah Property Rights Coalition Newsletter

April 4, 2008 Spring 2008, Vol. 1

UPRC Executive Officers

President: Chris Gamvroulas, Ivory Development

Vice President: Bill Perry, Jr., Perry Homes

Treasurer: Ryan Mecham, Anderson Development

UPRC Full Members:

Ivory Development

Perry Homes

Anderson Development

Garbett Homes

Development Associates

Hamlet Homes

Liberty Homes

The Sorenson Companies Rosecrest

Trophy Homes

Woodside Homes

Associate Land

In this issue:

- 2008 UPRC Legislative Recap
- 2008 UPRC Outlook
- Call for Recruitment of Affiliate and Associate Members

2008 UPRC Legislative Recap

The Utah Property Rights Coalition once again enjoyed a very successful legislative session. The top four priority bills for the UPRC all passed and have been signed by Governor Huntsman.

The success of the UPRC legislative agenda is due in large part to the efforts of many UPRC members. The UPRC Executive Officers (Chris Gamvroulas, Bill Perry, Jr., and Ryan Mecham) and others devote countless hours both during the legislative session and throughout the year working with the State Legislature and the Utah League of Cities and Towns to craft, and then pass, legislation that improves the environment in which we conduct business.

The UPRC also continues to be extremely well-served by our lobbyist team of Kyler, Kohler, and Ostermiller.

Without question, the biggest legislative victory for the industry this year was the passage of **SB 220**. Kudos to Taz Biesinger and the Utah Home Builders Association for leading the charge on SB 220. SB 220 would not have passed by such a large margin, and without significant amendment, without the efforts of the UPRC, the Utah Association of REALTORS®, and our lobbyists. It was a great team effort to pass a very important bill for the industry.

To recap, **SB 220** did the following:

Codifies existing Utah law (American Towers) and protects the free market and the ability of consumers and builders to contract to build a variety of types of housing without the fear of future lawsuits by tort lawyers. It does this by:

KW Management
UPRC Associate Member
Wasatch Capital
Utah Apartment Association
J & J Land Sons

Contacts

Justin V. Allen
justin@saltlakeboard.com
or
justin@kkclayton.com
801.698.5334

1. limiting defective design or construction causes of action to breach of contract claims, rather than third party tort claims such as "diminution of value."
2. Tort claims are still preserved for those who are physically injured by defective design or construction.

In addition to SB 220, all three of the UPRC-ULCT consensus bills passed. To review, those bills were:

Senate Bill 196--Sponsored by Senator Niederhauser and dealt with improvement assurances. The bill:

- Streamlines the process of getting a decision by a local government regarding subdivision improvements and warranty work. The builder can send a written request to get a decision within 15 days for improvements and within 45 days for warranty work. (There is an exception if winter weather delays the ability to make an inspection.);
- Requires that if the improvements or warranty work are rejected that the local government must "comprehensively and with specificity list the reasons for its determination." (This enables a builder to get a final and complete punch list to eliminate the problem of receiving multiple and changing punch lists.);
- Allows counties and municipalities to allow subdivision plat recording or development activity before completing required improvements if an improvement assurance is provided and other conditions are met;
- Prohibits counties and municipalities from imposing a requirement on the holder of an approved subdivision plat and issued land use permit that is not expressed in the plat, documents on which the plat is based, or the written record evidencing approval of the plat;
- Prohibits counties and municipalities from withholding acceptance of subdivision improvements because of a failure to comply with a requirement that is not expressed in the subdivision plat, documents on which the plat is based, or the written record evidencing approval of the plat; and
- Prohibits counties and municipalities from withholding issuance of a certificate of occupancy because of a failure to comply with a requirement that is not expressed in the written record evidencing approval of the building permit.

House Bill 177, sponsored by Representative Morley, creates a framework that regulates how local governments deal with potential geologic hazards. This is important because city and county powers currently have very few limits. The bill:

- Defines what a constitutes a flood plain as well as geologic hazards and potential geologic hazards;
- Limits a municipal government to regulate the above three items only to protect life and substantial loss of or damage to real property; and
- Creates a process to resolve a "battle of the experts" when it